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ENVIRONMENTAL AUDITS FOR REAL ESTATE PURCHASES:

A Quick Trip Through the Mine Field

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Has this happened to you? A client calls and tells you that she has made a good deal—the price is right—on a piece of commercial property. All she needs you to do is draw up the agreement of sale.

Wait! Get the agreement back from your secretary. You are about to leave yourself open for a major malpractice claim.

Today, representing a client in a commercial real estate transaction means more than just ensuring that the seller's title is clear. Lawyers must also assess and allocate the risk of potential environmental liabilities associated with commercial industrial, or agricultural property being acquired. The liability provisions of such statutes like CERCLA (the Federal Comprehensive Environmental Response, Compensation and Liability Act) indirectly impose a burden on purchasers of real estate to conduct all appropriate inquiries into the previous ownership and use of the property under consideration. Feigning ignorance about contamination that exists on a piece of commercial property—or arguing that your client did not cause the contamination—is not enough to absolve a landowner of liability under CERCLA.

Accordingly, an environmental assessment is important to realtors, purchasers, tenants, lenders and attorneys who



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want to know that the properties in which they have an interest are free from environmental hazards. The purchaser should take appropriate steps to determine whether environmental hazards exist. A Phase I Environmental Assessment ("Phase I") or due diligence review, through inquiry and assessment, effectively reduces risk and avoids acquiring interests in environmentally "impaired" properties. The Phase I provides an objective, independent and professional opinion of what potential environmental risks are associated with the property. This assessment is usually performed by a reputable environmental engineering consultant.

A Phase I gathers historical information regarding the property from the EPA, DER, local planning commission, other federal, state or local agencies, historical records of the property, reports, permits, or maps. Records are scanned for any environmental history associated with the property such as spills, past hazardous activities and state or federal CERCLA (or "Superfund") sites located near (usually within one mile) of the property. The hydrogeologic makeup of the property (soil, depth to water, and ground water flow directions) is also examined.

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A physical inspection of the property is another aspect of Phase I. During the inspection, the environmental consultant reviews the operations occurring on the property. He or she also conducts employee interviews to glean information about practices in dealing with hazardous or toxic materials. Buildings are assessed for asbestos and PCBs. Also studied by the consultant are: fuels stored on the property including type, classification and quantity, and hazardous materials and/or waste stored or used at the site; current as well as past waste disposal practices; obvious spill or leak areas; and the existence of on-site wells or borings on the property.

After a thorough review of the site, a written report is submitted by the environmental consultant. If the Phase I report indicates the possibility of environmental contamination, a Phase II Environmental Assessment ("Phase II") is necessary. A Phase II requires a more detailed review of the property and includes analysis of soil and water samples taken from the property itself. This review will either resolve any uncertainty concerning environmental liability or quantify the extent of such liability.

The results of Phase I and Phase II environmental assessments are often used in negotiating the final price or terms of a contract of sale for property. The objective in negotiation is to allocate the risk for environmental liability between the parties. There are alternative ways to accomplish this.

Warranties

By including warranties in the agreement of sale, the seller may represent that the seller's records of hazardous and toxic materials used on the property are complete and accurate; that environmental permits are in place and freely transferable; and that there are no outstanding notices of violations or enforcement actions involving the property. If possible, these warranties should extend beyond the final closing date of the sale agreement. However, in most cases, the seller will resist either including warranties in the first place or allowing them to extend beyond the final closing date of the agreement. This is a negotiating point to be worked out between the parties.

Indemnification

Indemnification clauses serve to shift risk. The seller of the property indemnifies the buyer for any clean-up costs incurred. Indemnification agreements *will not* reduce the liability of the prospective purchaser with regard to CERCLA, but will provide a basis for recovery against the seller. Indemnification agreements can include establishing a bond or escrow account for prospective clean-up costs.

A word of caution: an indemnification agreement is only as good as the financial stability of the indemnitor. When negotiating such indemnification agreements, the prospective buyer must carefully consider the financial viability and long-term prospects of the indemnifying party. (This is where requiring a bond or escrow account makes good sense.)

Insurance

A method of protecting your client from environmental liability is through "First Party Pollution Cleanup/Environmental Remediation Insurance." The seller pays for the coverage. The purchaser is the insured or "First Party". This type of coverage, however, is only for a limited period of time. Further, this coverage only covers clean-up costs that are required to comply with a government mandate. Of course, the seller will balk at providing such insurance because the premiums are expensive. If such coverage is acquired, your client should make sure that defense costs and third party liability coverage (for damages to other property) are specifically provided for in the policy. Lenders will also want to be sure they are named as additional insureds. While this type of insurance is expensive and limited in its duration, it provides a higher degree of certainty than an indemnification agreement that funds will be available if needed for environmental clean-up.

Creative lawyering is a must in negotiating environmental issues in real estate sale agreements. For instance, to avoid the necessity of insurance, indemnities or warranties, you may want the seller to remediate the site by removing hazardous waste and nonhazardous waste requiring a removal permit. The purchase price can be adjusted to reflect the environmental hazards. Or you can ask the seller to delete contaminated land from the sale.

The purchase of commercial real estate is a mine field for the unwary. The attorney for a buyer of commercial real estate should seek assistance of a colleague knowledgeable in environmental law to assist with the environmental portions of the sales agreement. ♦

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